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Clerk of the Board
California Air Resources Board
1001 I Street
Sacramento, California 95814

IETA COMMENTS ON DRAFT AMENDMENTS TO THE REGULATIONS FOR LINKING WITH QUEBEC CAP-AND-TRADE PROGRAM

On behalf of the International Emissions Trading Association (IETA), I am grateful for the opportunity to provide comments, in response to California Air Resource Board's release of "Amendments to the California Cap on Greenhouse Gas Emissions and Market-Based Compliance Mechanisms to Allow for the Use of Compliance Instruments Issued by Linked Jurisdictions". I hope that ARB considers IETA's perspectives and insights as it moves forward with the linking process.

IETA extends its appreciation to California for the release of draft regulatory amendments, taking into consideration the linking of its cap-and-trade program with other Western Climate Initiative (WCI) partners. The aim of the WCI is to take cooperative actions to address climate change, and linking programs is a critical component of achieving this goal. Linking provides an opportunity for a more robust allowance market to emerge across jurisdictions. Importantly, linking reduces the overall combined costs of the programs by broadening the scope of available mitigation opportunities and further sparking competition to innovate and mitigate. In short, linking could lead to more effective price discovery. Additionally, linking increases market liquidity and reduces transaction costs by involving more market participants, thereby decreasing the potential for market manipulation. A carefully designed and well-executed linkage of these programs, which builds off valuable experiences and lessons learned from other environmental markets, will help maximize these improvements as well as maintain California's growing international reputation as a climate policy leader.

INTRODUCTION

IETA is dedicated to the establishment of market-based trading systems for greenhouse gas emissions that are demonstrably fair, open, efficient, accountable, and consistent across national boundaries. IETA has been the leading voice of the business community on the subject of emissions trading since 2000. Our 160 member companies include some of North America's, and the world's, largest industrial and financial corporations—including global leaders in oil & gas, mining, power, cement, aluminum, chemical, pulp & paper, and investment banking. IETA also represents a broad range of global leaders from the industries of: data verification and certification; brokering and trading; offset project development; legal and advisory services.

For over a decade, IETA has remained committed to its vision of a global greenhouse gas market. To this end, IETA has facilitated thought leadership on linking through its original research. In 2007, in preparation for COP 13 in Bali, IETA commissioned Dr. Robert Stavins (Harvard University) and Judson Jaffe (formerly Vice President of the Analysis Group) to write the first comprehensive report on linking. Since this report, IETA has continued to view linking as a critical component of creating a consistent, fair and cost-effective international framework for reducing greenhouse gases.



OVERVIEW OF SUBMISSION

The changing of the first auction date to November has had—and will continue to have—a mixed impact on stakeholders. On one hand, the additional time gives covered entities more time to prepare for a successful auction. However, “delays” also may decrease the likelihood that liquidity providers—including financial intermediaries such as banks, traders and brokers—will participate in the market; this is especially true for larger liquidity providers, who compare opportunities in the carbon market to those in more traditional—typically much less risky—markets. To this end, it is important that the program gets started.

In the context of linking, IETA recommends that ARB considers taking a step-wise approach to linking with Quebec, especially if pursuing a fully joint auction may provide additional delays. Specifically, holding a separate but coordinated auction with Quebec would allow for more time to ensure that each jurisdiction’s programs works well before holding a fully joint auction.

The recommendations contained in this particular submission are broken down into the following four categories:

1. Recommendations for the Know-Your-Customer Requirements
2. Identification of Differences in Quebec and California Compliance Obligations and Deadlines
3. Recommendations for ARB’s Draft Amendments
4. Clarifications Regarding Auction Bid Processes

IETA’s intent is to assist ARB, in any way helpful, to strike the right balance between market oversight and market effectiveness. Furthermore, IETA looks forward to future discussions with ARB staff.

1. KNOW-YOUR-CUSTOMER RECOMMENDATIONS

IETA is concerned that ARB’s rules governing the Know-Your-Customer (KYC) requirements too heavily emphasize market oversight at the expense of market participation. IETA believes slight adjustments to the KYC requirements will ensure widespread and successful participation in ARB’s program without sacrificing the security of the market. Accordingly, IETA recommends the following adjustments to ARB’s KYC requirements:

Consider a policy that removes requirements for publicly traded companies that comply with U.S. Securities and Exchange Commission (SEC). SEC regulated companies are closely regulated by multiple Federal Agencies. Furthermore, they are required to disclose much detailed information that is readily researchable. IETA believes ARB could work in conjunction with the SEC to 1) ensure appropriate market oversight and 2) maximize participation by avoiding requiring publicly traded companies that comply with SEC to disclose similar information twice. Therefore, IETA recommends that ARB considers exempting publicly traded companies that are in compliance with the SEC from ARB’s KYC requirements.



Consider removing onerous requirements for personal information. IETA believes requiring that individuals disclose excessively onerous information, such as requiring personal bank account information, to gain access to the tracking system is unnecessary. Accordingly, IETA recommends ARB consider eliminating provisions requiring overly onerous information disclosure. At least, IETA urges ARB to consider differentiating requirements for individuals who are applying for access to accounts for 1) strictly viewing purposes and 2) purposes that include additional responsibility (i.e. an authorized account representative). For individuals falling in the former category, IETA recommends eliminating the provisions that require disclosure of overly onerous personal information.

Clarification regarding moral turpitude. The definition of moral turpitude—“conduct that is considered contrary to community standards”—is too broad to be used as a basis for barring eligibility for account access. IETA recommends ARB provide additional clarity on the specific violations that would preclude account access.

Electronic document submission should be allowed. The KYC requirements in place in the European Union Emissions Trading Scheme (EUETS), like the requirements proposed in these draft amendments, require notarized documentation. However, in contrast to the EUETS, ARB does not grant itself the additional authority to use electronic mechanisms to check disclosed information. This requirement is unnecessary and could prove to be excessively costly. Therefore, IETA recommends that ARB authorize the use of electronic mechanisms to check any personal information.

2. DIFFERENCES IN COMPLIANCE OBLIGATIONS AND DEADLINES

As IETA highlighted in its last submission to ARB, harmonizing compliance obligations and deadlines is a prerequisite for a functioning, linked carbon market. Currently, Quebec’s regulation has no annual compliance obligation and a compliance period that ends in October—while California’s compliance periods end in November. While IETA understands that this round of ARB amendments is not the only process for which Quebec and California’s regulations can be harmonized, IETA wanted to take this commenting opportunity to underscore the importance of harmonizing both compliance obligations and deadlines.

3. RECOMMENDATIONS FOR REMAINING DRAFT AMENDMENTS

Price Floor

IETA recognizes and appreciates that ARB has created a process with which, for an auction with two currencies, an exchange rate will be fixed before the auction so the separate California and Quebec price floors can be harmonized. However, ARB’s selection of the higher of the two price floors is inappropriate; any resulting price difference would purely be based on exchange rates and picking the higher value does nothing but unnecessarily raise compliance costs. Indeed, in extreme cases, the price floor could be higher than the reserve tiers in the Allowance Price Containment Reserve (APCR). Therefore, IETA recommends switching this language to use the lower of the two values or, at least, the average of the two values.



Allowance Price Containment Reserve

IETA has taken no official stance on whether 1) the allowances within each jurisdiction's price ceiling reserves should be transferrable for compliance between jurisdictions or 2) if reserve tier prices should be harmonized to account for differences in exchange rates. However, IETA was intrigued by ARB's comment, during ARB's April 9 workshop, that price divergences between the two tiers would have negligible impact on market behavior because the tiers would empty out so quickly. Does ARB have publicly available modeling to underpin this statement? IETA would be grateful for any modeling results, or additional information, that ARB could provide on this matter.

Changes in the Transfer Process

IETA views ARB's switch to a push-push-pull method for transfer requests as unnecessary and unprecedented—these regulations seem to bear no relation to traditional commercial markets. IETA recommends the following:

Eliminating the requirement for three representatives to sign off on a transfer. While IETA understands ARB's intent behind requiring three representatives to sign off on a transfer request—to provide security and prevent theft and fraud—IETA believes that companies will effectively prevent theft and fraud through their own, internal control systems. Therefore, IETA recommends removing this requirement.

If provisions are retained, consider additional modifications. The deadlines associated with a transfer—48 and 24 hours, respectively—to report a settlement of the transaction to ARB and to confirm the transfer receipt is extremely short and unnecessarily burdens companies. Therefore, IETA recommends ARB consider eliminating or, at least, lengthening these deadlines. In addition, IETA recommends ARB modify the language to read two or one *business days*, respectively, instead of 48 and 24 hours. This would prevent inconvenient situations where account representatives would have to sign off on transfers over a weekend or holiday.

Number of Individuals Associated with an Account

IETA commends ARB for allowing the designation of more account representatives. This amendment will enhance the ability of entities to efficiently manage their accounts.

Consolidation of Accounts between Entities with Direct Corporate Association

IETA commends ARB for switching from a facility-level to a corporate-level process for accounts, through amendments allowing for consolidation of accounts with direct corporate association.

Holding Limit

IETA prefers ARB's original regulations for holding limits, which apply the holding limit for future vintage year allowances to all vintages within that compliance period. The change in the draft amendments—for the holding limit for future vintage year allowances to apply to each vintage year



allowance—provides an unnecessary restriction on companies, particularly large companies who will have a difficult time meeting their compliance obligation with current holding limit rules.

IETA was pleased to hear that, at least in concept, ARB is not absolutely foreclosing the option of increasing auction frequency in the future. Increasing auction frequency would preclude the need for additional measures that attempt to prevent market manipulation—like holding or auction purchase limits. In addition, more frequent auctions could result in a faster learning curve for companies and more opportunities to become comfortable with the auction platform.

In addition, IETA requests clarification around the penalty in the case that allowance holdings in excess of an entity's holding limits are found. During the April 9 workshop, it seemed that even if an excess was remedied within the cure period that additional penalties could be exacted through ARB enforcement. IETA would appreciate clarification surrounding penalties for 1) when an entity is found to be in excess and remedies the excess within the cure period and 2) when an entity is found to be in excess and fails to remedy the excess within the cure period. Specifically, in the latter case, what penalties occur in addition to the excess allowances being consigned to auction?

4. QUESTIONS REGARDING AUCTION BID PROCESSES

Regarding how long a loser's bid is held, IETA would appreciate further clarification on the timeline under which a losing bid will be returned to a company.

CONCLUDING REMARKS

The recommendations expressed in these comments are intended to improve market efficiency and liquidity. Releasing draft regulatory amendments ahead of linking with WCI partners is a positive step towards achieving greater liquidity, and IETA's recommendations will build upon these amendments and further enhance the efficiency of the cap-and-trade program to drive emissions reductions at the lowest-cost.

IETA reiterates its gratitude to ARB for the opportunity to provide comments, and welcomes further opportunities to engage regarding the linking process. If any further details or clarifications are needed, please do not hesitate to contact Clayton Munnings (munnings@ieta.org) or +1 202 629 5980.

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